INFORMATION BULLETIN

July 6, 2012 **2012-5**

HARMONIZATION WITH CERTAIN MEASURES OF THE FEDERAL BUDGET OF MARCH 29, 2012

On March 29, 2012, the Minister of Finance of Canada presented the federal government's budget for 2012. This budget includes various fiscal measures that affect the tax system.

Along with the budget, the federal Minister of Finance tabled, in the House of Commons, supplementary information as well as notices of ways and means motions[1] to amend the Income Tax Act[2] and the Excise Tax Act,[3] among others.

In this regard, Québec's tax legislation and regulations will be amended to incorporate some of the measures announced. However, the changes to Québec's tax system will only be adopted following the assent given to any federal statute or adoption of any federal regulations giving effect to the retained measures, taking into account technical amendments that may be made prior to such assent or adoption. Lastly, these changes will apply on the same dates as those retained for the purposes of the federal measures with which they are harmonized.

❑ Measures relating to income tax

■ Measures retained

Québec's tax legislation and regulations will be amended to incorporate, with adaptations on the basis of their general principles, the measures relating to:

1. registered disability savings plans regarding:
   - persons who can become holders of such plans,
   - maximum and minimum withdrawal amounts,
   - the tax-free transfer of the investment income earned in a registered education savings plan,

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1 DEPARTMENT OF FINANCE CANADA, *Economic Action Plan 2012 – Jobs, Growth and Long-Term Prosperity*, March 29, 2012, Annex 4, Tax Measures: Supplementary Information, Notices of Ways and Means Motions and Draft Amendments to Various GST/HST Regulations, p. 373.

2 R.S.C., 1985, c. 1 (5th Supp.).

3 R.S.C., 1985, c. E-15.

- the election allowed the holder of such plans to extend the maximum period during which a plan may remain open where the beneficiary ceases to qualify for the disability tax credit, it being understood that where a valid election is made for federal income tax purposes, the same election will be deemed to have been made for Québec income tax purposes and that in the absence of a valid election for federal income tax purposes, no election will be possible for Québec income tax purposes,

- certain administrative requirements imposed on issuers (BR 1 in part);[4]

2. the designation of part of a dividend as eligible dividend and late designation of an eligible dividend (BR 3);

3. the tax on excess employees profit sharing plan[5] amounts (BR 12 to BR 14), it being understood that the tax payable by a specified employee for a year will be calculated at the rate applicable to the top taxable income bracket of the personal income tax table;[6]

4. the changes concerning tax avoidance through the use of partnerships that hold income assets (BR 22 to BR 26);

5. the waiver by a designated partner of a partnership, on behalf of all its partners, of the three-year time limit for making a determination (BR 27);

6. the change to the debt-to-equity ratio applicable to thin capitalization rules (BR 29);

7. the application of the thin capitalization rules to the debts owed by partnerships of which a Canadian-resident corporation is a member (BR 30);

8. the changes designed to exclude from the application of the thin capitalization rules the portion of interest included in the calculation of a corporation's income on account of foreign accrual property income of a controlled foreign affiliate of the corporation (BR 32);

9. the changes concerning foreign affiliate dumping (BR 33 to BR 36, BR 37 in part,[7] BR 38 in part[8] and BR 39);

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4 The references in parentheses correspond to the number of the budget resolution (BR) of the Notice of Ways and Means Motion to Amend the Income Tax Act tabled in the House of Commons on March 29, 2012.

5 For the purposes of Québec's tax system, the employees profit sharing plan is called a profit sharing plan.

6 This rate is currently 24%.

7 Québec's tax legislation will not be harmonized with the federal tax legislation concerning the addition of sub-paragraph 128.1(1)c.3)(ii) to the Income Tax Act.

8 Québec's tax legislation will not be harmonized with the federal tax legislation concerning the addition of paragraph 212.3(2)*a*) to the Income Tax Act.

10. the gradual elimination of the overseas employment tax credit (BR 41), it being understood that these measures will be transposed to the deduction for employment abroad whose gradual elimination will be effected by applying, to the amount allowable as a deduction otherwise calculated, a percentage of 75% for taxation year 2013, 50% for taxation year 2014 and 25% for taxation year 2015, and except that the current rules continue to apply to taxation years prior to the year 2016 in respect of commitments made before January 1, 2013;[9]

11. the enhancement to transparency and accountability of charities and Canadian amateur athletic associations (BR 43), whose application will be extended to Québec amateur athletic associations;

12. the period of validity of a tax shelter identification number (BR 45);

13. the penalties imposed on tax shelter promoters (BR 46 and BR 47);

14. the addition of blood coagulation monitoring devices to the list of expenses qualifying for the medical expenses tax credit;[10]

15. the changes concerning the accelerated capital cost allowance regarding clean energy generation equipment applicable to waste-fuelled thermal energy equipment, equipment that is part of a district energy system and equipment that uses residue of plants to generate electricity and heat.[11]

Moreover, for greater clarity, although it requires no legislative or regulatory amendments, the federal measure relating to the definition of "qualified donee" will also be retained for the purposes of Québec's tax system (BR 42*a*)).

■ Measures not retained

Some measures have not been retained because they do not correspond to the features of Québec's tax system, because Québec's tax system is satisfactory or has no corresponding provisions. This applies to the measures on:

— the introduction of a proportional repayment rule for grants and bonds paid by the federal government to a registered disability savings plan (BR 1 in part);

— the one-year extension of the mineral exploration tax credit for flow-through share investors (BR 2);

— the application of anti-avoidance rules to retirement compensation arrangements (BR 6 to BR 11);

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9 For greater clarity, in the case where an individual's duties are tied to a contract pursuant to a written commitment of a specified employer of the individual made before January 1, 2013, the percentage applicable regarding the portion of the amount allowed as a deduction otherwise calculated that is attributable to such contract will be 100%. As of taxation year 2016, the deduction will be eliminated in all cases.

10 DEPARTMENT OF FINANCE CANADA, *Economic Action Plan 2012, op. cit.*, p. 382.

11 *Ibid.*, p. 403 to 405.

— the taxation of the salary of the Governor General of Canada (BR 15);

— the gradual elimination of the corporate tax credit for pre-production mining expenditures (BR 17);

— the gradual elimination of the Atlantic investment tax credit for oil, gas and mining activities (BR 18);

— the addition of electricity generation and clean energy generation equipment to the definition of qualified property for the purposes of the Atlantic investment tax credit (BR 19);

— the change designed to reduce the rate of the investment tax credit on account of the scientific research and experimental development (R&D) (BR 20*a*) and BR 20*b*));

— the reduction to 80% of the amount of a research contract entered into with a person at arm's length (BR 20*c*) in part);

— the changes applicable to the treatment of secondary adjustments and the treatment of an amount of a primary adjustment that a non-resident is authorized to repatriate for the purposes of the transfer pricing rules (BR 28);

— the treatment of interest expenses not deductible as a result of the application of the thin capitalization rules on account of dividends for the calculation of tax under Part XIII of the Income Tax Act (BR 31);

— the changes concerning foreign affiliate dumping resulting in a deemed dividend for the purposes of Part XIII of the Income Tax Act (BR 37 in part[12] and BR 38 in part[13]);

— the changes to the calculation of the tax a corporation leaving Canada is required to pay[14] (BR 40);

— the designation of a foreign organization for the purposes of the definition of the expression "qualified donee" (BR 42*b*));

— the power granted to the Minister of National Revenue to assess a penalty for failure to comply with the requirements concerning the filing of returns on tax shelters (BR 44).

Similarly, measures relating to the tax treatment of amounts paid for an employee to a group sickness or accident insurance plan (BR 4 and BR 5) have not been retained, since the rules in Québec's tax legislation are already sufficient to achieve the objective of these measures.

12 See note 7.

13 See note 8.

14 This is the tax under Part XIV of the Income Tax Act.

However, to maintain the integrity of Québec's tax system, a clarification will be made to the tax legislation to stipulate that the value of the benefit stemming from contributions paid by an employer to a group insurance plan in relation to protection against total or partial loss of income from an office or employment will be taxable, in the event that the benefit arising from such protection is not payable periodically. This clarification will apply on the same dates as those proposed for the federal measures relating to amounts paid to a group sickness or accident insurance plan.

■ Subsequent announcements

The Ministère des Finances du Québec will make known its position on the change proposed to the exemption criteria of life insurance policies at a later date (BR 16), since these proposals will be the subject of consultations with major stakeholders.

Moreover, in view of the potential impact harmonization with some changes made to the R&D program might have, the Ministère des Finances is continuing to study the matter and will make known its position at a later date regarding the following measures:

— the exclusion of the portion of the amount of a research contract entered into with a person at arm's length relating to capital expenditures (BR 20*c*) in part);

— the change to the R&D program concerning the percentage at which the amount in lieu of overhead expenditures is calculated (BR 20*d*));

— the exclusion of capital expenditures (including payments in respect of the use or the right to use property that would, if it were acquired by a taxpayer, be capital property of the taxpayer) from expenditures giving rise to the R&D deductions and tax credit (BR 20*e*));

— any other change necessary to give effect to the various changes to the R&D program (BR 21).

The Ministère des Finances du Québec will also announce at a later date its position regarding the changes to be formulated by the Department of Finance Canada and will apply to Canadian banks in relation to the rules against erosion of the tax base regarding foreign accrual property income.[15]

15 DEPARTMENT OF FINANCE CANADA, *Economic Action Plan 2012, op. cit.*, p. 425.

❑ Measures relating to the goods and services tax and the harmonized sales tax

Changes will be made to the Québec sales tax system to incorporate, with adaptations on the basis of its general principles, the federal measures relating to the application of the goods and services tax (GST) and the harmonized sales tax (HST) in the health sector (BR 1 to BR 16),[16] the doubling GST/HST streamlined accounting thresholds (Sec 1 to Sec 3) and GST/HST relief for foreign-based rental vehicles temporarily imported by Canadian residents (BR 18, BR 19 and Sec 4 to Sec 9).

Moreover, the measure relating to the GST rebate for books to be given away for free by prescribed literacy organizations (BR 17) has not been retained, since Québec's tax system is satisfactory in this regard.

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For information concerning the matters dealt with in this information bulletin, contact the Secteur du droit fiscal et de la fiscalité at 418 691-2236.

The French and English versions of this bulletin are available on the Ministère des Finances website at: www.finances.gouv.qc.ca.

16 The references in parentheses correspond, as the case may be, to the number of the budget resolution (BR) of the Notice of Ways and Means Motion to Amend the Excise Tax Act or the number of the section (Sec) of the draft amendments to various GST/HST regulations tabled in the House of Commons on March 29, 2012.
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